IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

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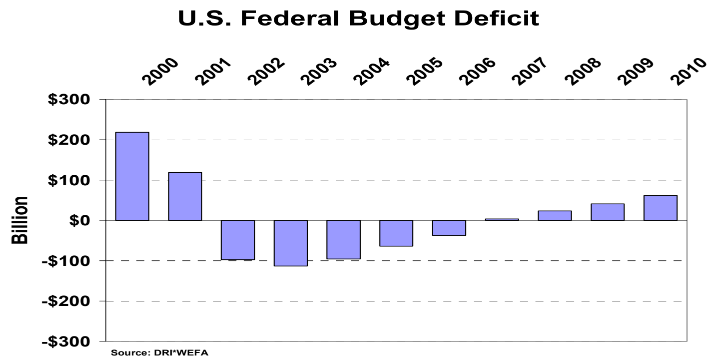
One of the most anticipated events of the summer was the release of the second installment of the *Star Wars* saga titled "Attack of the Clones." Economists, on the other hand, are dealing with another type of attack this summer that is proving to be about as popular as Jar Jar Binks. After disappearing from the radar screen for several years, the recent return of the twin national deficits (federal budget and trade) is starting to create much hand wringing among economists.

The return of the federal budget deficit (NIPA basis) in fiscal year 2002 is a 180-degree change from the surpluses of the previous four years. What had seemed impossible just a few short years ago became reality when the federal budget experienced a surplus in 1998. This was not a fluke; the federal government enjoyed surpluses in the next three years as well. The last time the U.S. posted a similar string of surpluses was just after World War II. And many economists believed that surpluses would continue beyond just those four years. In fact, official government forecasts predicted there would be surpluses over the foreseeable future. Such a run of surpluses would create opportunities not imagined possible just a few years ago. For example, instead of borrowing money, the federal government would be in the rare position of paying down the national debt. In fact, what almost no one had expected to see in their lifetimes, the retiring of the nation's huge debt, had seemed possible in just a few short years. All that was needed to achieve this milestone was no economic calamities and a bit of luck.



Unfortunately, the nation's luck seems to have run out sooner than later. As a result, the federal budget deficit should return this year. Several factors have contributed to the swing of a $119 billion surplus in 2001 to a predicted $97 billion deficit this year. First, and most obvious, is the national recession. The federal budget reels from the double blows of falling revenue growth and rising spending on safety net programs. While some of the revenue decline is due to the soft economy, another portion of it reflects national tax relief efforts that will take the effective U.S. personal income tax as a percent of GDP from nearly 10% in 2001 to 9.0% in 2002. On the spending-side of the budget, federal transfer payment growth to persons is expected to accelerate. But it is not the only item that should increase. The events of September 11, 2001 have led to higher defense spending for national security. For example, spending on national defense rose almost twice as fast in 2002 compared to the previous year.

As a result, the federal government will once again need to borrow money to pay its bills. One impact of the deficit is the plan to pay down the national debt will be derailed. When the federal government becomes a borrower it increases the demand for limited funds, which puts upward pressure on interest rates. This will have a negative impact on the interest rate-sensitive sectors of the economy. And persistently high rates could affect the nation's long-term economic health by discouraging capital investment that would raise future productivity. Fortunately, the current string of deficits is not expected to be as long the previous one. It is predicted the federal budget will again post surpluses beginning in 2007.

The other half of this two-headed Hydra is the trade deficit. From 1992 to 2001, the trade deficit (NIPA) basis) swelled from $28 billion to $330 billion. This reflects the favorable conditions for imports compared to exports during this period. The expansion in imports occurred during the nation's record economic growth. During this period, part of American's seemingly insatiable demand was satisfied by imports. Concurrently, many countries experienced less prosperous times, so their purchases of U.S. exports suffered. In addition, some of these countries attempted to export their way out of their economic doldrums, which further deteriorated the U.S. trade balance. Further tilting the balance toward imports was a strong U.S. dollar. There was a positive side to of increased imports. The flood of inexpensive goods helped keep prices domestic prices under control. The negative side was the strong dollar hurt U.S. exporters competitiveness on the world market. Ultimately, increased imports were a drag on national output. No one seemed to notice it when real GDP was expanding by 4.0%. But it is starting to get attention now because the economy is growing about half as fast.

The dollar has slipped noticeably in recent months, and is expected to continue falling over the next few years. However, the dollar's retreat is expected to be gradual, so it will not be large enough to turn around the nation's trade situation. The current forecast shows the U.S. trade deficit widening further from $330 billion in 2001 to just under $550 billion in 2010. With no relief in sight, trade is expected to be a continued drag on the U.S. economy.

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General Fund Update

As of May 31, 2002

Revenue Source	FY02 Executive Estimate[3] ($ Millions)	DFM Predicted to Date ($ Millions)	Actual Accrued to Date ($ Millions)
Individual Income Tax	940.2	888.1	791.8
Corporate Income Tax	93.4	73.9	65.2
Sales Tax	659.4	601.5	600.4
Product Taxes[1]	20.6	18.8	19.1
Miscellaneous	110.6	59.6	59.4
TOTAL GENERAL FUND[2]	**1,824.2**	**1,641.9**	**1,536.0**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of January 2002

General Fund revenue was $5.6 million lower than expected in May. Once again, the majority of the shortfall ($3.6 million) is concentrated in the Individual Income Tax. Additional weakness was felt in the Corporate Income Tax, Sales Tax, and Miscellaneous Revenue. Only the Product Tax category managed to come in ahead of the target for May. On a year-to-date basis General Fund revenue is now $105.9 million (6.4%) below the target amount. Actual year-to-date revenue is 14.5% lower than the same period a year ago.

Individual Income Tax gross collections were $4.5 million lower than expected in May, but this was tempered by refunds that were $0.8 million lower than expected. The year-to-date shortfall has grown to $96.3 million. Although May's actual refund amount was almost $12 million lower than it would have been had the refund account not run out of cash in late May, the total amount of refunds that are now expected in May and June combined are very close to the target amount. So, the excess refunds that were not recorded in May would have had the effect of distorting May's refund level beyond the level normally seen, and June's level would have been abnormally low. Their combined impact would have still been very close to the target amount. The reason the refund account went dry in May is because an estimated $24.5 million in excess withholding collected from February to June of 2001 (due to the rate reduction enacted in the 2001 legislative session) had to be refunded this fiscal year.

Corporate Income Tax revenue was $0.9 million lower than expected in May, bringing the year-to-date shortfall to $8.7 million. Although May's net revenue number is very close to the expected amount, it masks large variances in the components. Quarterly estimated payments were low by $3.6 million for the month, but this weakness was offset by refunds that were $1.6 million lower than expected and filing collections that were $1.1 million higher than expected.

Sales Tax collections were a mere $0.1 million lower than expected in May. The year to date shortfall is now $1.1 million, and the variance remains at just 0.2%.

Product taxes were $0.1 million ahead of the target in May, and the Miscellaneous category was $1.1 million below the target for May. The Miscellaneous weakness was concentrated in interest earnings.